STRICTLY CONFIDENTIAL (FR) CLASS I-FOMC

Material for

Staff Presentation to the Federal Open Market Committee

February 6, 1990

Basic Policy Assumptions

- Monetary policy will be aimed at achieving a reduction in inflation over time, in the context of continued economic expansion.

- Fiscal policy will remain moderately restrictive.

  -- For FY91, a deficit-reduction package of about $30 billion

  -- No dramatic multi-year budget accord

Financial Projections

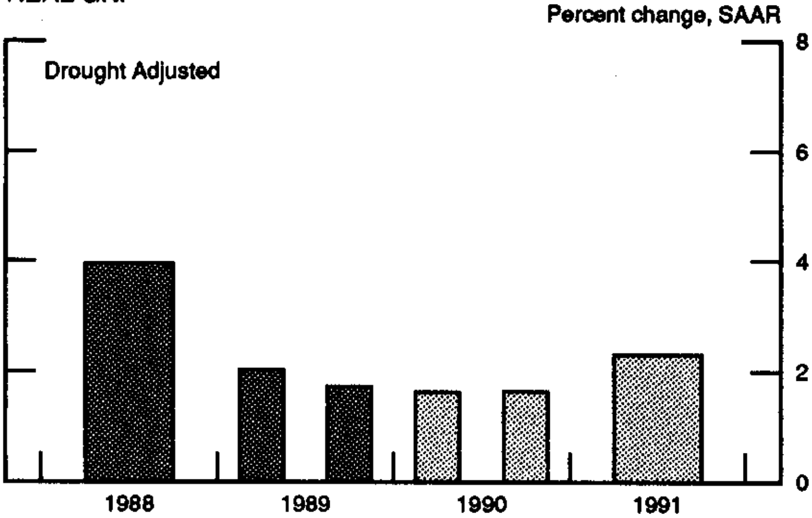
- Interest rates do not move far from recent levels; they may average a little higher in 1991 than in 1990.

- M2 will grow around 6-1/2 percent in 1990 and 6 percent in 1991.

- Federal budget deficit will decline from $152 in FY89 to $137 in FY90 and to $118 in FY91.

- The dollar will depreciate moderately over the next two years.

REAL GNP

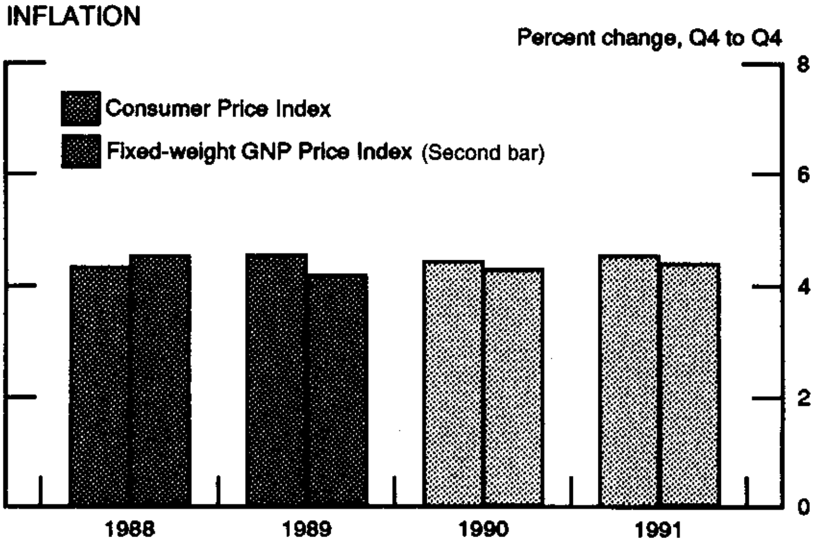


	Percent change Q4 to Q4	
	Drought Adjusted	Actual
1988	4.0	3.4
1989	1.9	2.4
1990	1.6	1.6
1991	2.3	2.3

CIVILIAN UNEMPLOYMENT RATE

Q4 level	
1988	5.3
1989	5.3
1990	5.9
1991	6.1

INFLATION

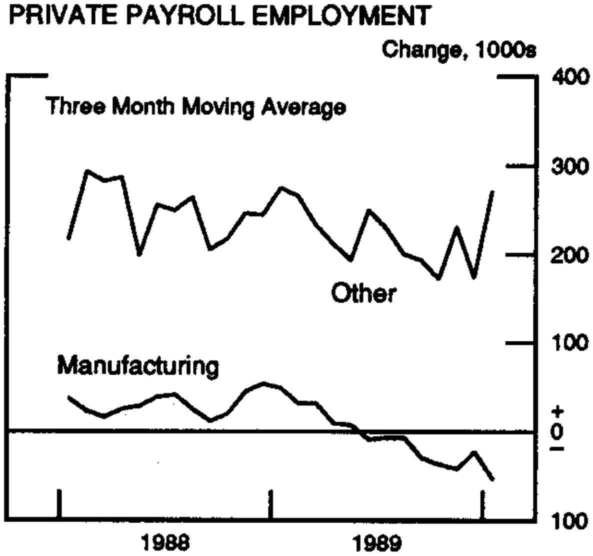


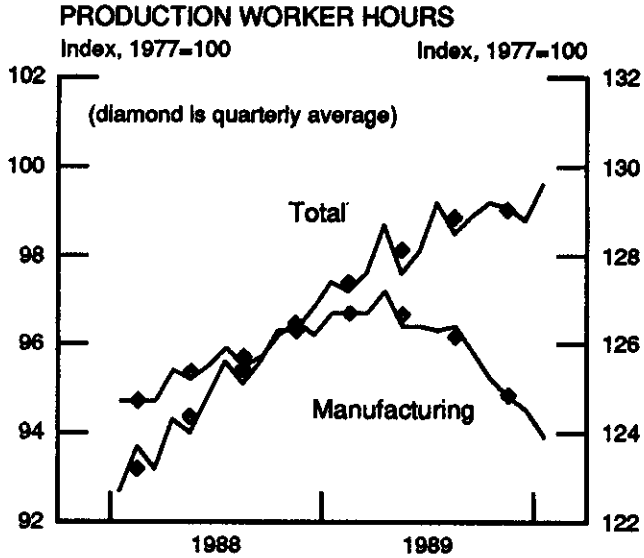
	Percent change Q4 to Q4	
	CPI	Fixed-weight GNP
1988	4.3	4.5
1989	4.5	4.1
1990	4.4	4.2
1991	4.5	4.3

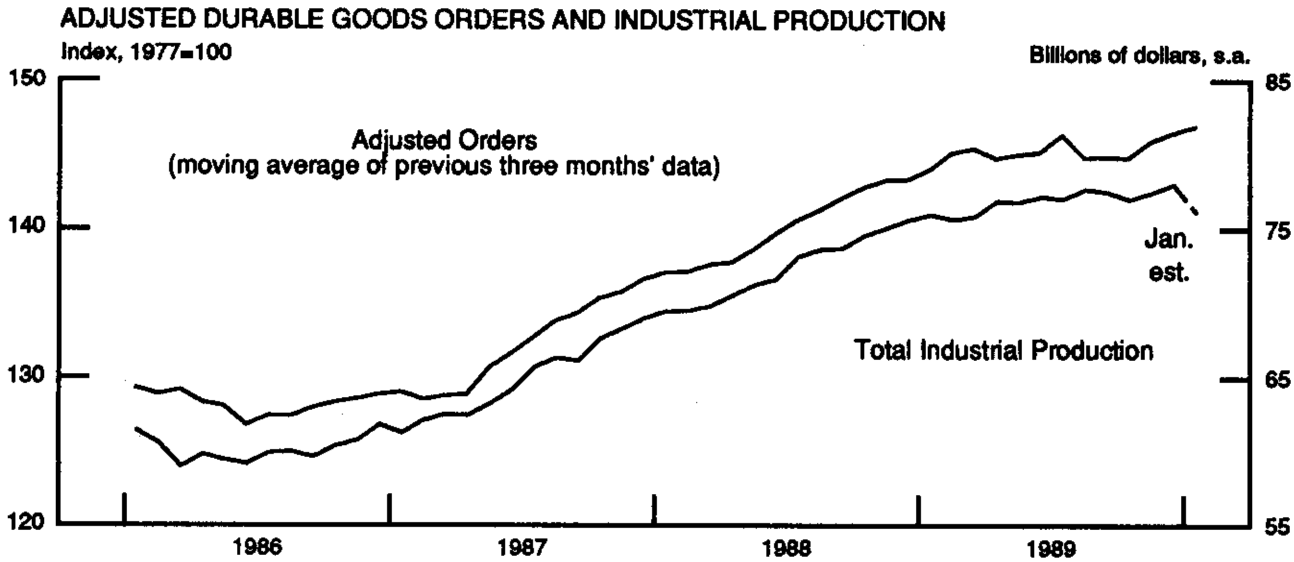
ECONOMIC PROJECTIONS FOR 1990

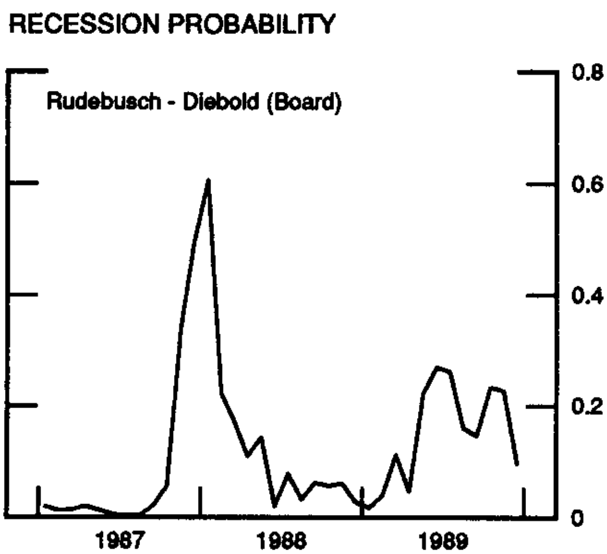
	FOMC			
	Range	**Central Tendency**	**Administration**	**Staff**
	Percent change, Q4 to Q4			
Nominal GNP	4 to 7	5-1/2 to 6-1/2	7.0	5.7
July 1989 forecast	*4-1/4 to 7-1/2*	*5-1/2 to 6-3/4*	*6.8*	*6.0*
Real GNP	1 to 2-1/4	1-1/2 to 2	2.6	1.6
July 1989 forecast	*1 to 2-1/2*	*1-1/2 to 2*	*2.6*	*1.6*
CPI	3-1/2 to 5	4 to 4-1/2	4.1	4.4
July 1989 forecast	*3 to 5-3/4*	*4-1/2 to 5*	*4.1*	*4.6*
	Average level, Q4, percent			
Unemployment Rate	5-1/2 to 6-1/2	5-1/2 to 5-3/4	5.4	5.9
July 1989 forecast	*5 to 6-1/2*	*5-1/2 to 6*	*5.4*	*6.1*

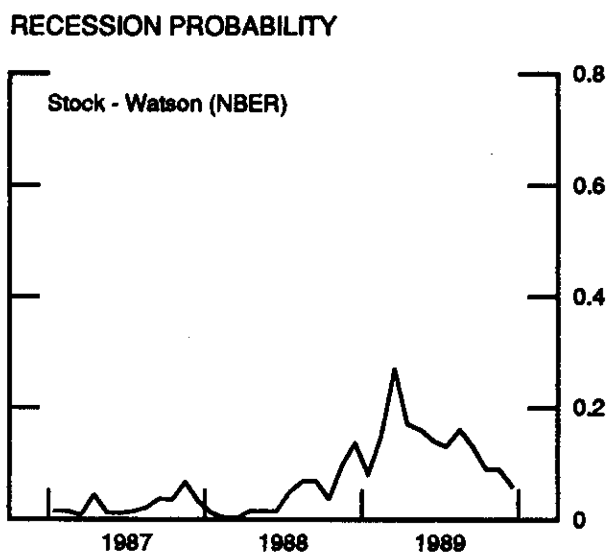
Chart 4


PRIVATE PAYROLL EMPLOYMENT
Change, 1000s
Three Month Moving Average
Other
Manufacturing
400
300
200
100
+
0
-
100
1988
1989

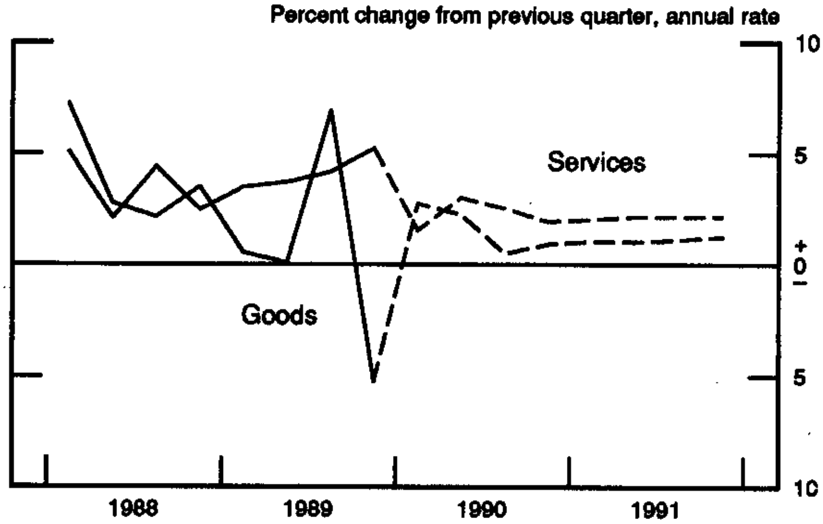

PRODUCTION WORKER HOURS
Index, 1977=100
Index, 1977=100
(diamond is quarterly average)
Total
Manufacturing
102
100
98
96
94
92
132
130
128
126
124
122
1988
1989


ADJUSTED DURABLE GOODS ORDERS AND INDUSTRIAL PRODUCTION
Index, 1977=100
Billions of dollars, s.a.
Adjusted Orders
(moving average of previous three months' data)
Jan.
est.
Total Industrial Production
150
140
130
120
85
75
65
55
1986
1987
1988
1989


RECESSION PROBABILITY
Rudebusch - Diebold (Board)
0.8
0.6
0.4
0.2
0
1987
1988
1989

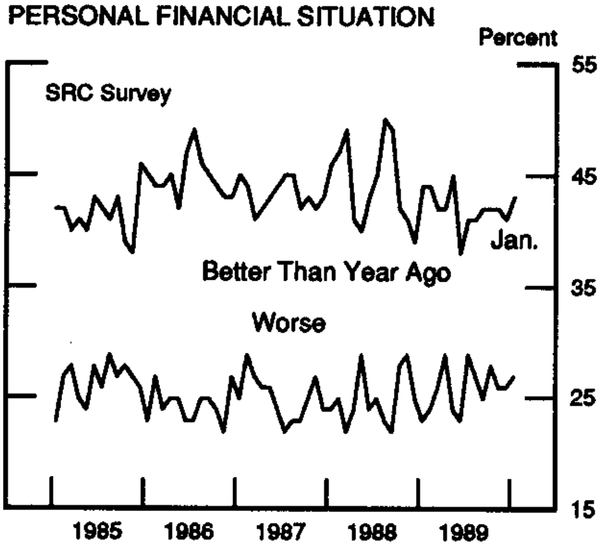

RECESSION PROBABILITY
Stock - Watson (NBER)
0.8
0.6
0.4
0.2
0
1987
1988
1989

PERSONAL CONSUMPTION EXPENDITURES

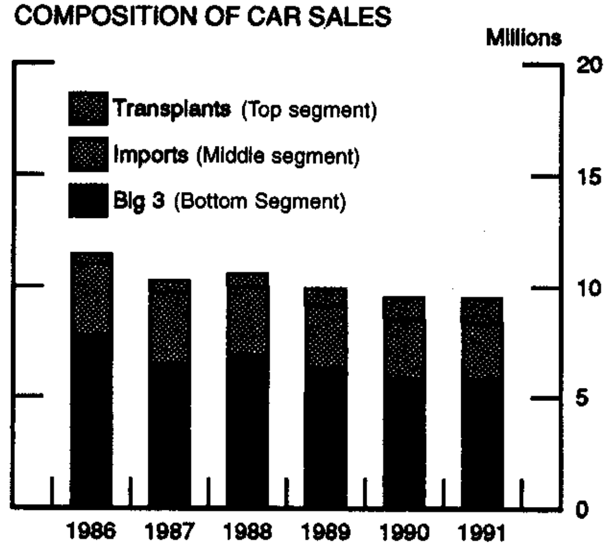


	Percent change Q4 to Q4 Total PCE	DPI
1988	3.8	4.0
1989	2.3	3.6
1990	2.0	1.2
1991	1.6	1.4

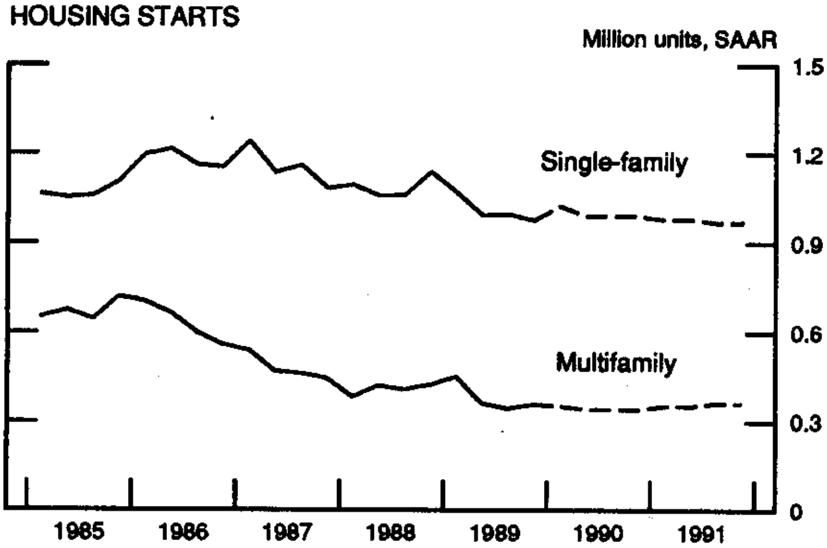
PERSONAL FINANCIAL SITUATION



COMPOSITION OF CAR SALES

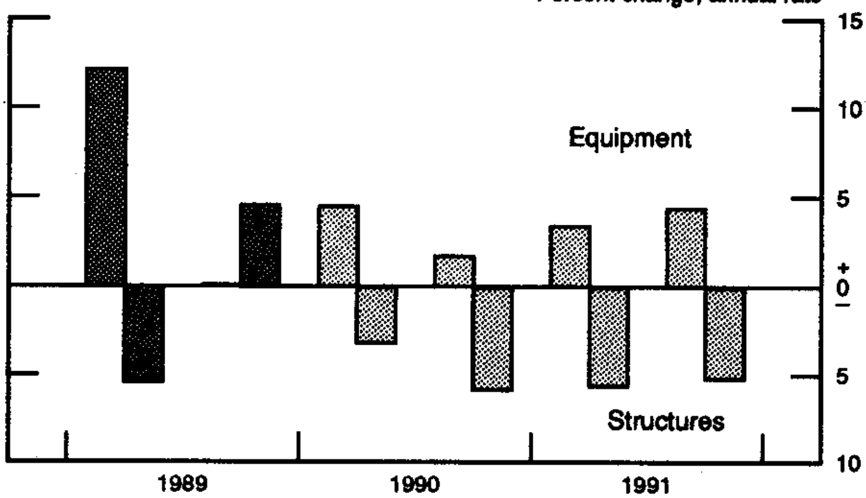


HOUSING STARTS



Total Starts Millions of units, SAAR	
1985	1.74
1986	1.81
1987	1.62
1988	1.49
1989	1.37
1990	1.34
1991	1.33

REAL BUSINESS FIXED INVESTMENT

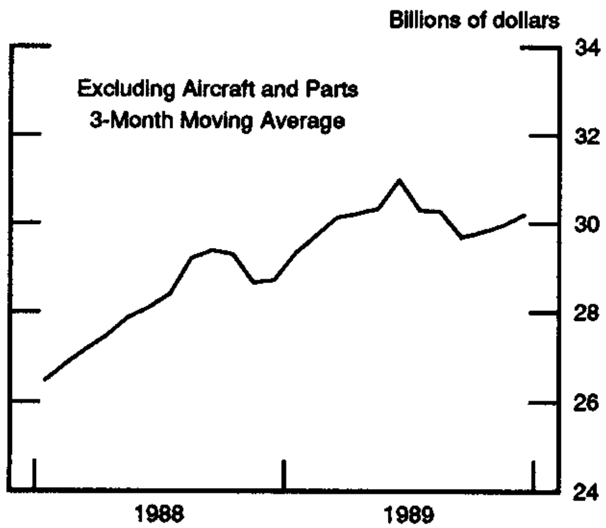


Total Real BFI

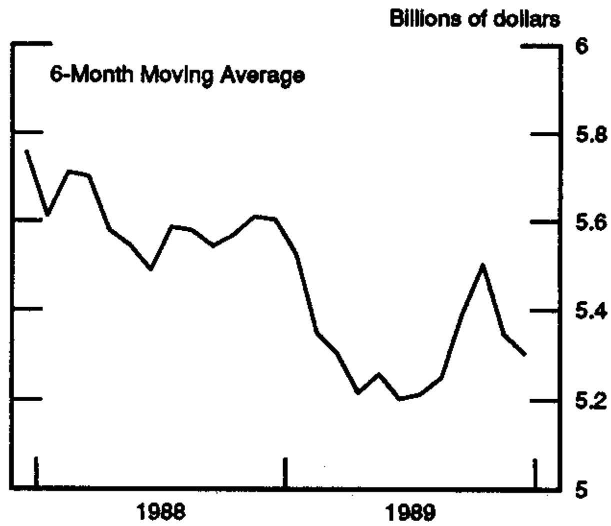
Percent change, annual rate

1988	4.2
1989	4.3
1990	1.3
1991	1.8

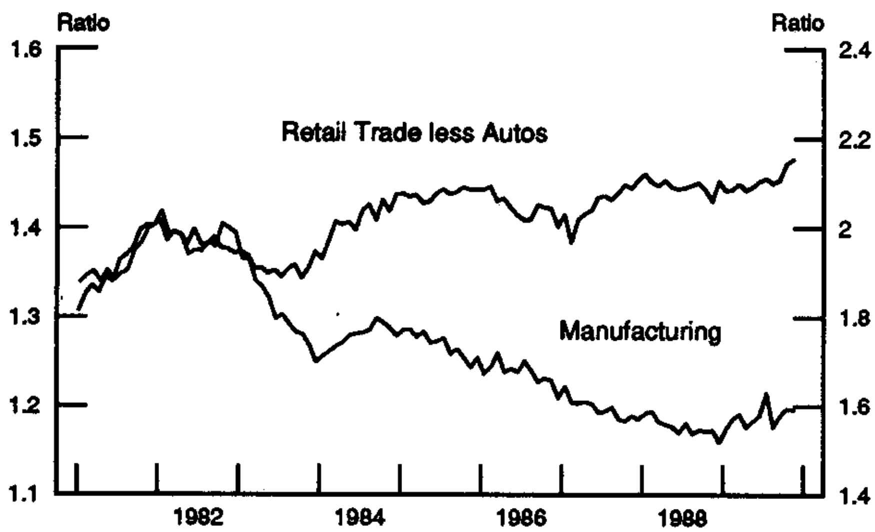
NONDEFENSE CAPITAL GOODS ORDERS



CONTRACTS FOR NONRES. STRUCTURES



REAL INVENTORY-SALES RATIOS



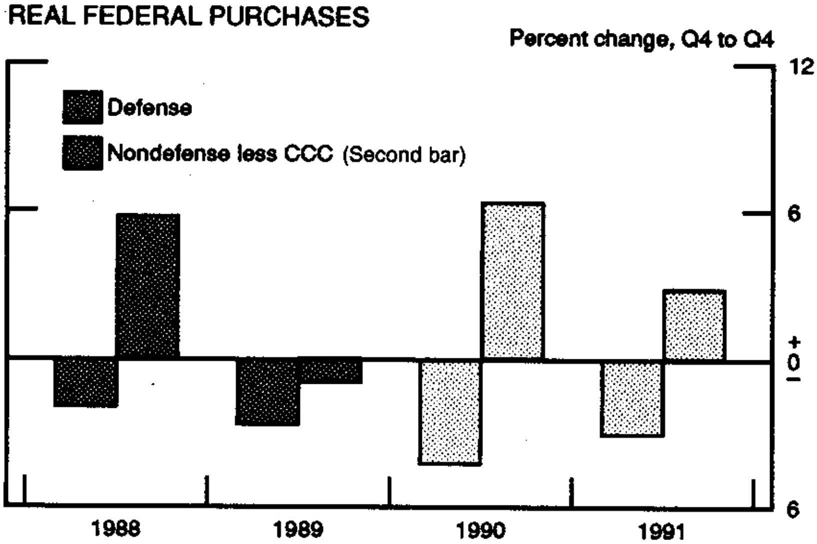
Nonfarm Inventory Investment

1982 dollars, SAAR

	Auto	Other
1989 Q4	3.2	28.1
1990 Q1	—16.7	10.5
Q2	—3.7	7.4
H2	—1.0	10.5
1991 H1	0	15.8
H2	0	18.8

Chart 7

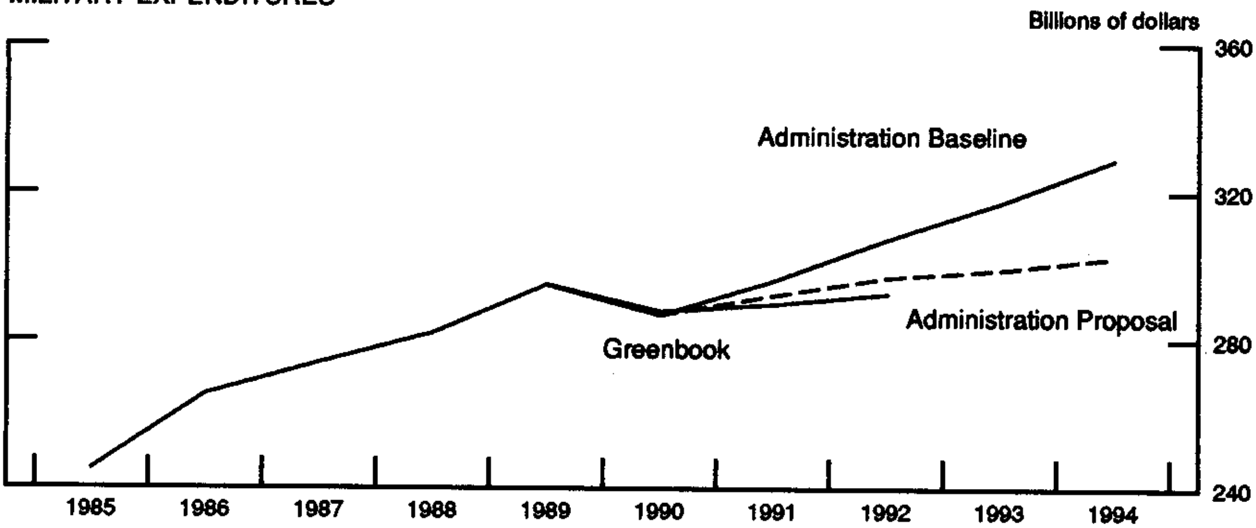
REAL FEDERAL PURCHASES



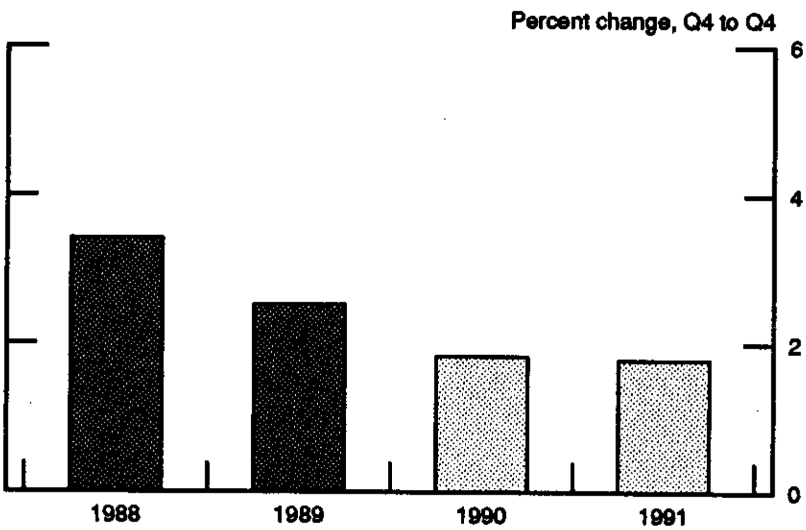
Percent change Q4 to Q4

	Total	Total ex. CCC
1988	—.3	—.1
1989	—3.0	—2.3
1990	—.5	—1.6
1991	—1.5	—1.5

MILITARY EXPENDITURES



REAL STATE AND LOCAL PURCHASES

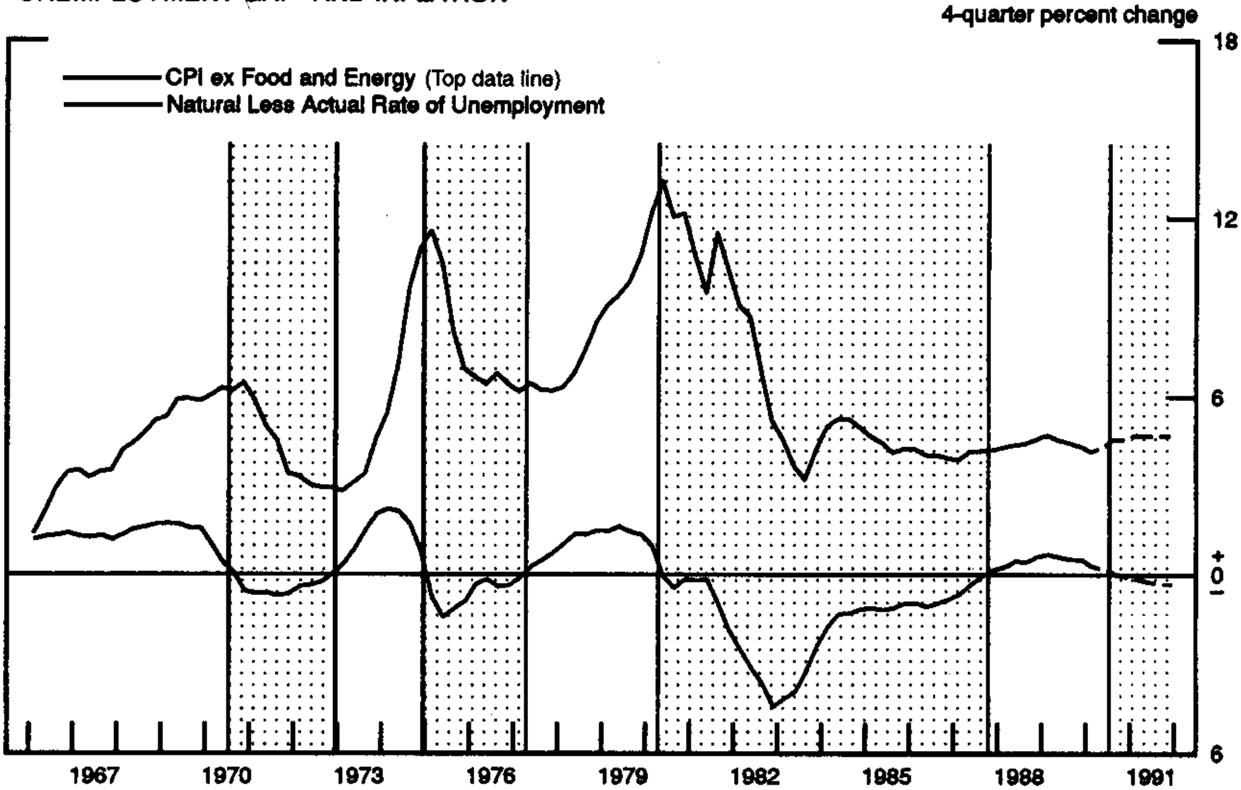


State and Local Operating Deficit

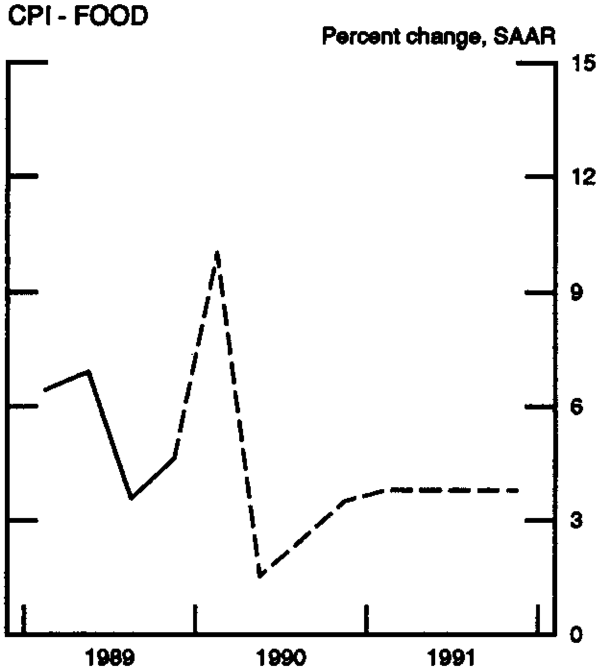
Billions of dollars

1988	21.4
1989	33.0
1990	38.9
1991	28.1

"UNEMPLOYMENT GAP" AND INFLATION



CPI - FOOD



CPI - ENERGY

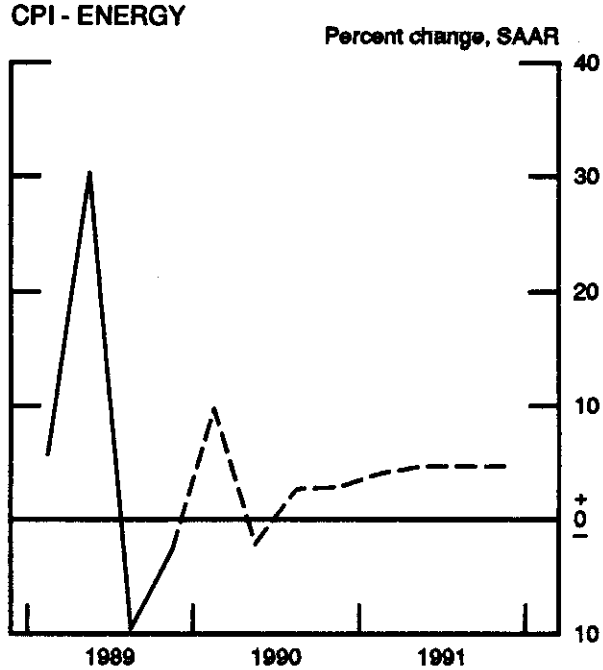
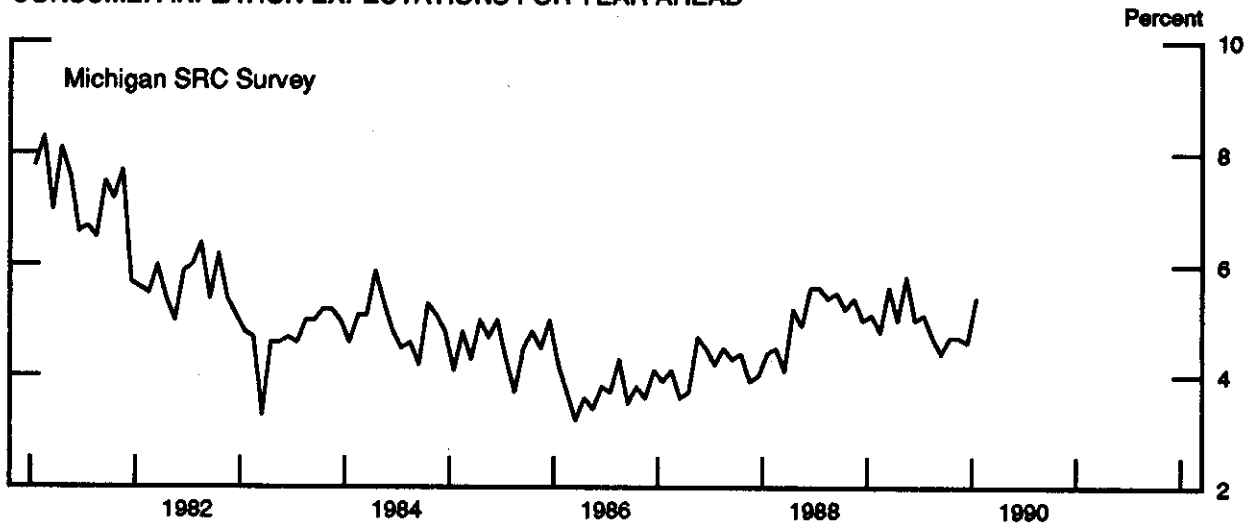
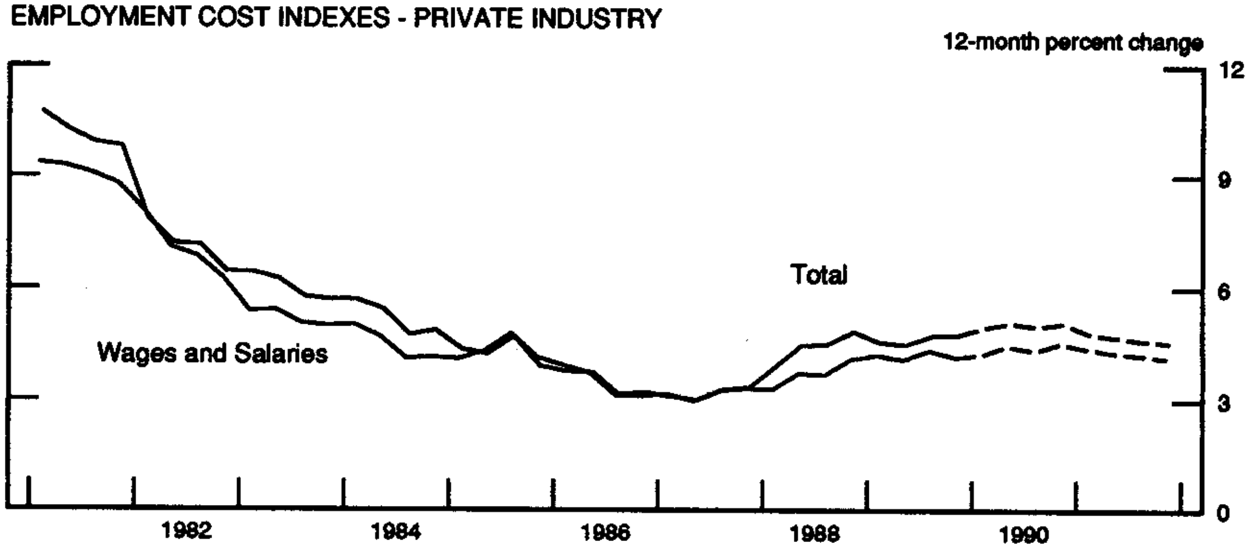


Chart 9

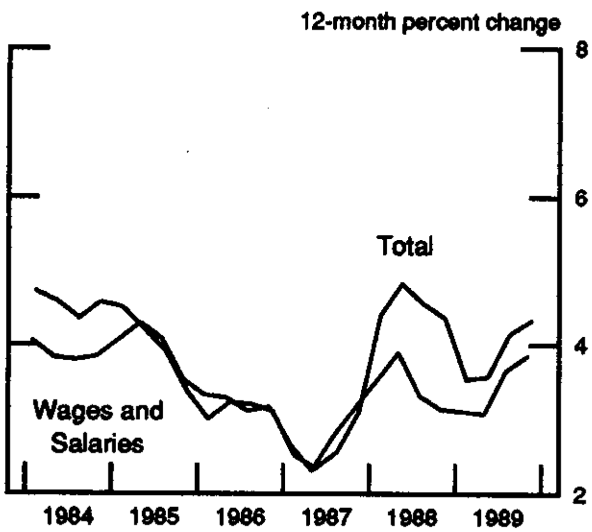
CONSUMER INFLATION EXPECTATIONS FOR YEAR AHEAD



EMPLOYMENT COST INDEXES - PRIVATE INDUSTRY



ECI - GOODS PRODUCING



ECI - SERVICE PRODUCING

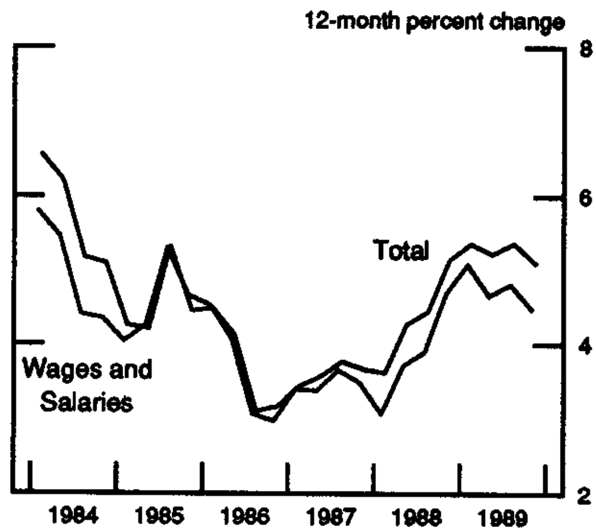
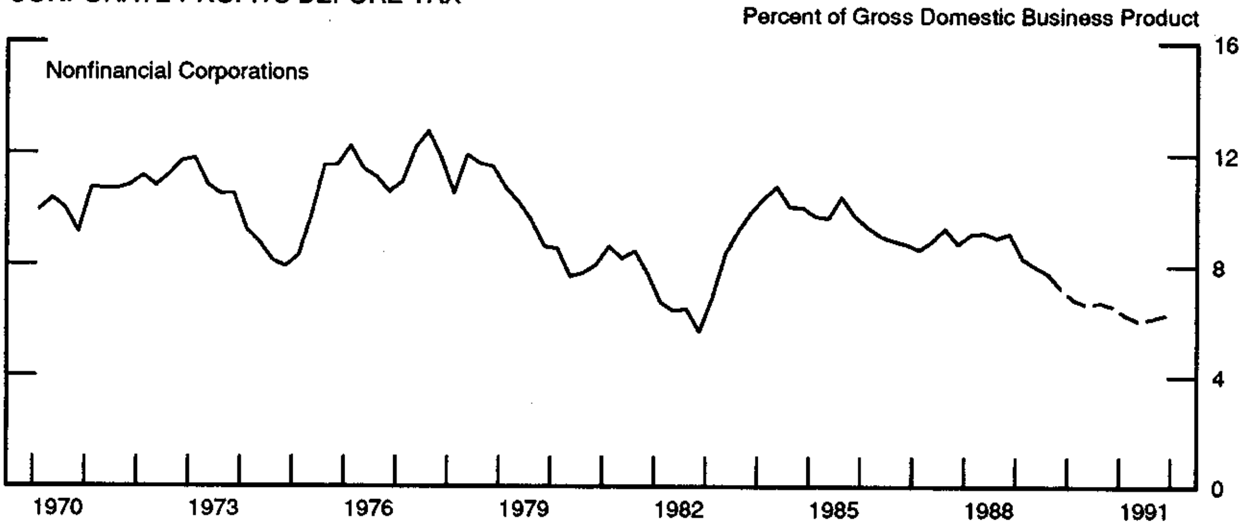
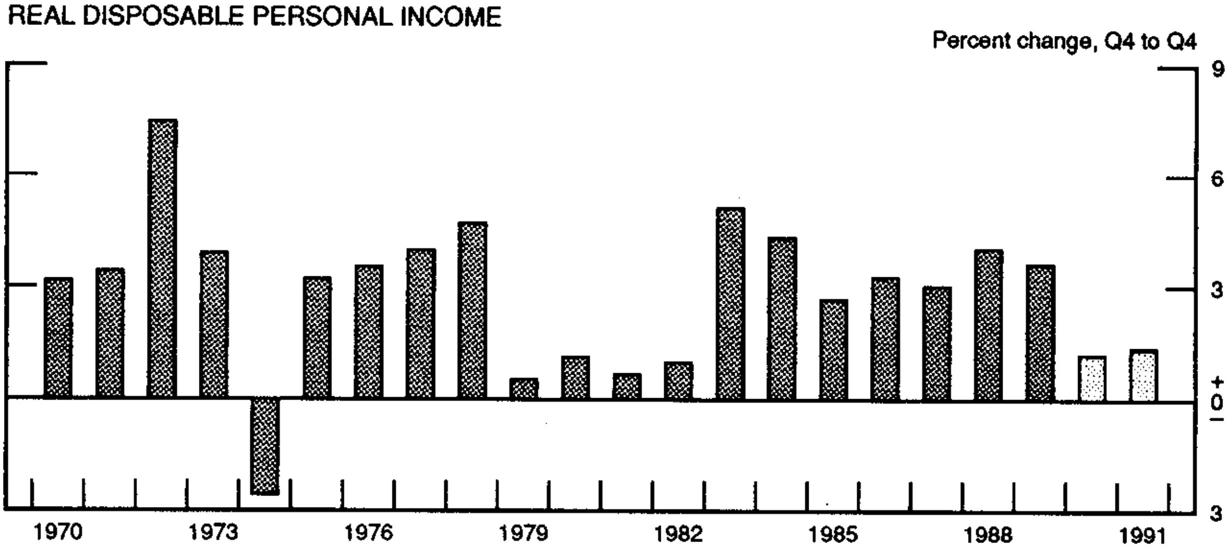


Chart 10

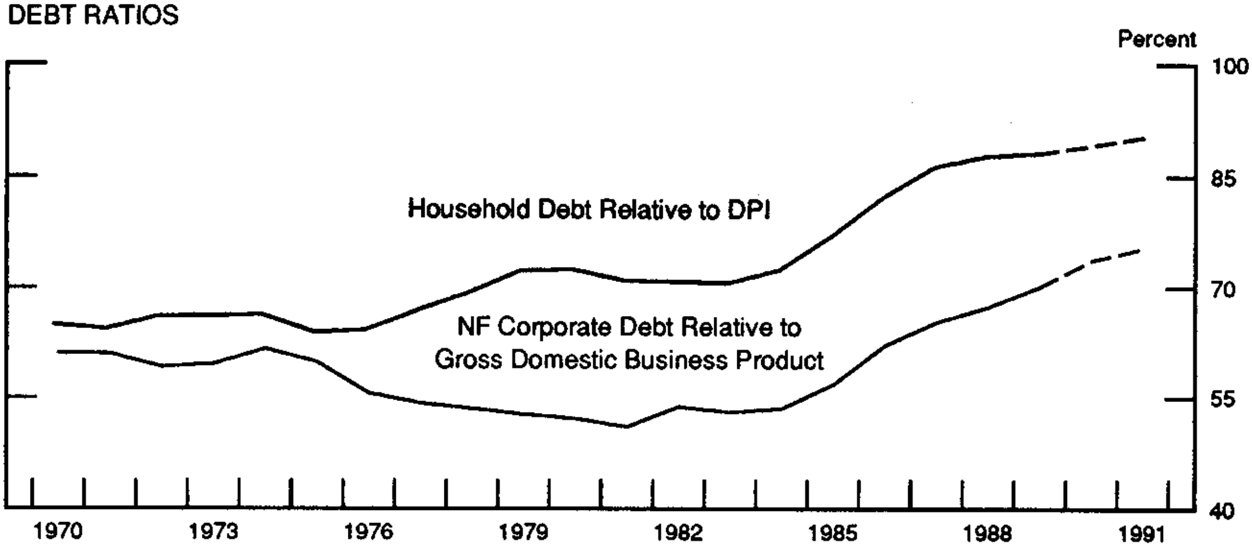
CORPORATE PROFITS BEFORE TAX



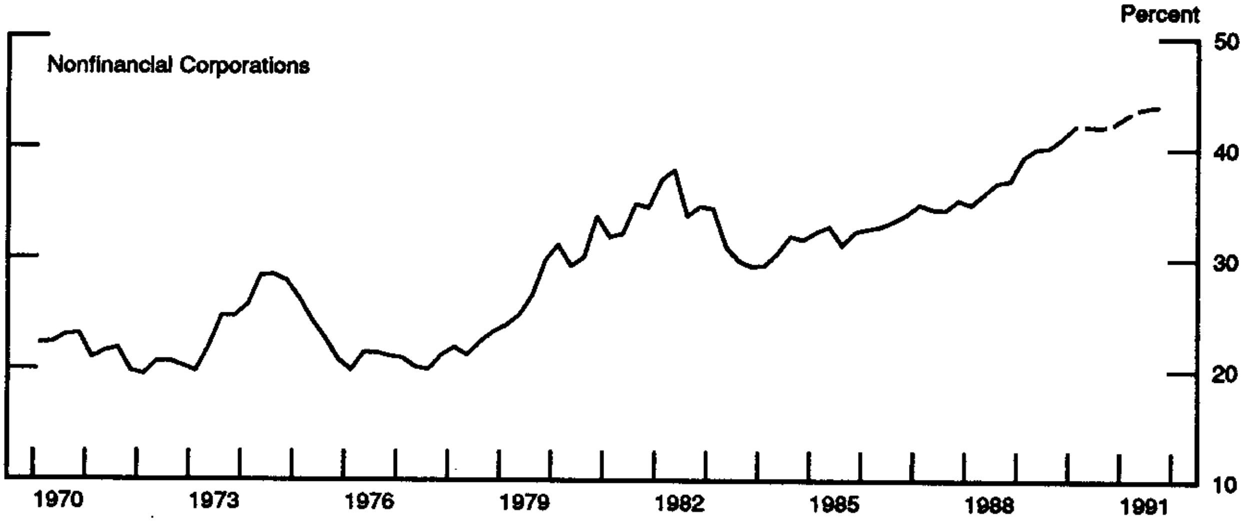
REAL DISPOSABLE PERSONAL INCOME



DEBT RATIOS

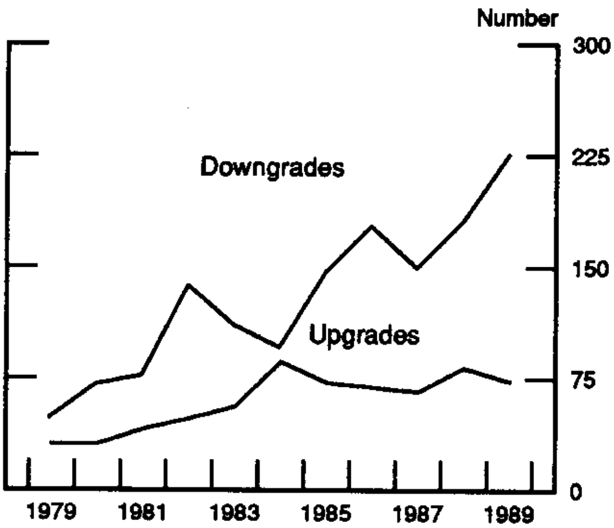


INTEREST PAYMENTS RELATIVE TO CASH FLOW*



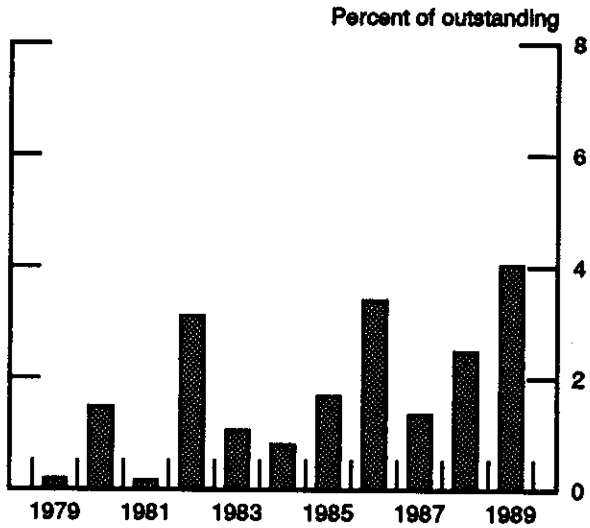
* Gross interest payments relative to cash flow including interest payments.

RATING CHANGES ON CORPORATE BONDS



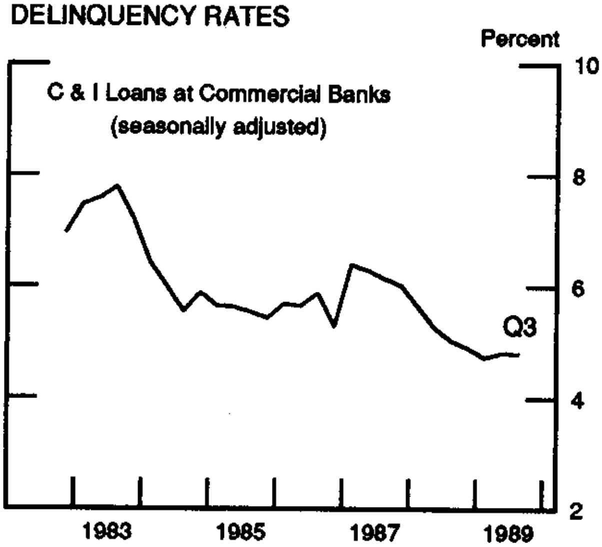
Moody's series

DEFAULTS ON LOW-RATED BONDS

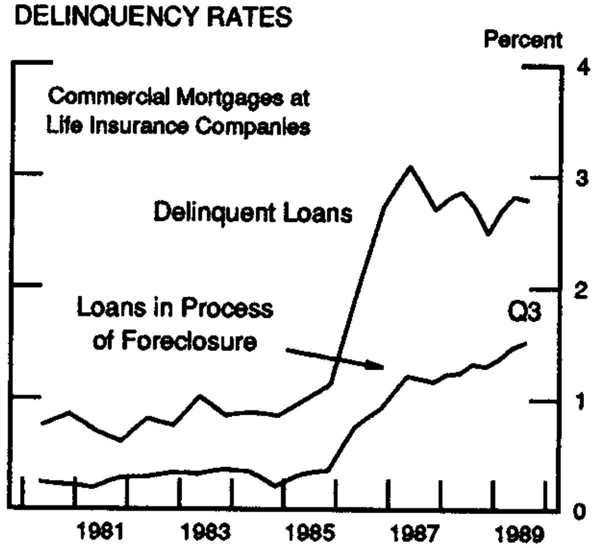


1987 excludes Texaco.

DELINQUENCY RATES



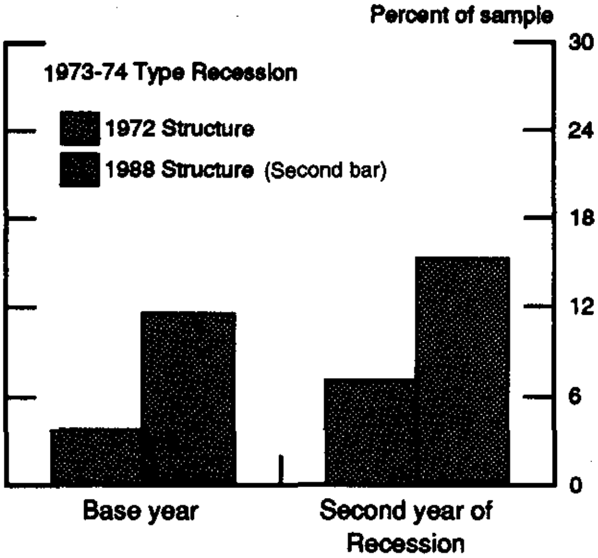
DELINQUENCY RATES

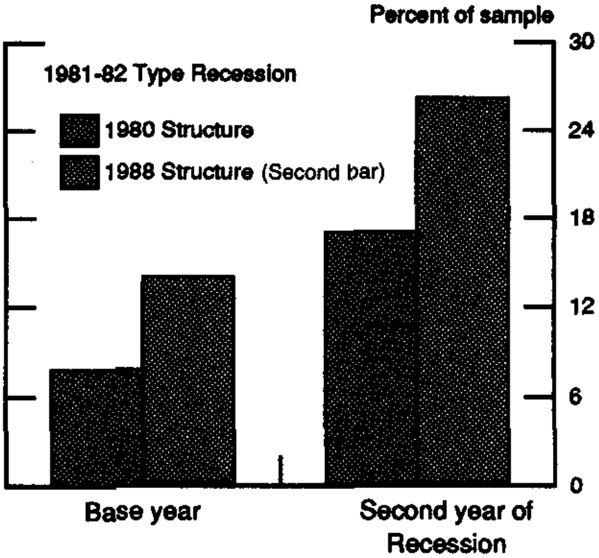


Delinquent loans include loans in the process of foreclosure.

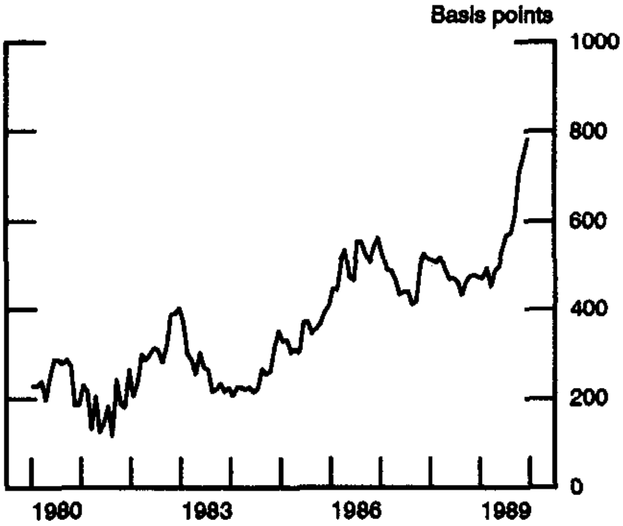
Chart 12

FIRMS WITH INTEREST EXPENSE EXCEEDING CASH FLOW



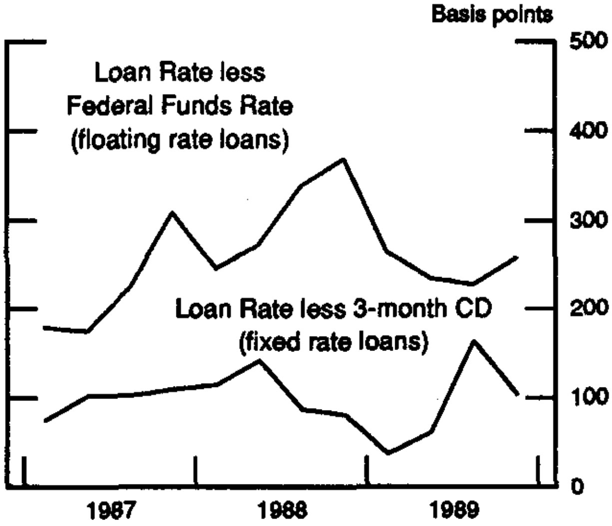


JUNK BOND SPREAD



Merrill Lynch series

SPREADS ON C & I LOANS AT BANKS



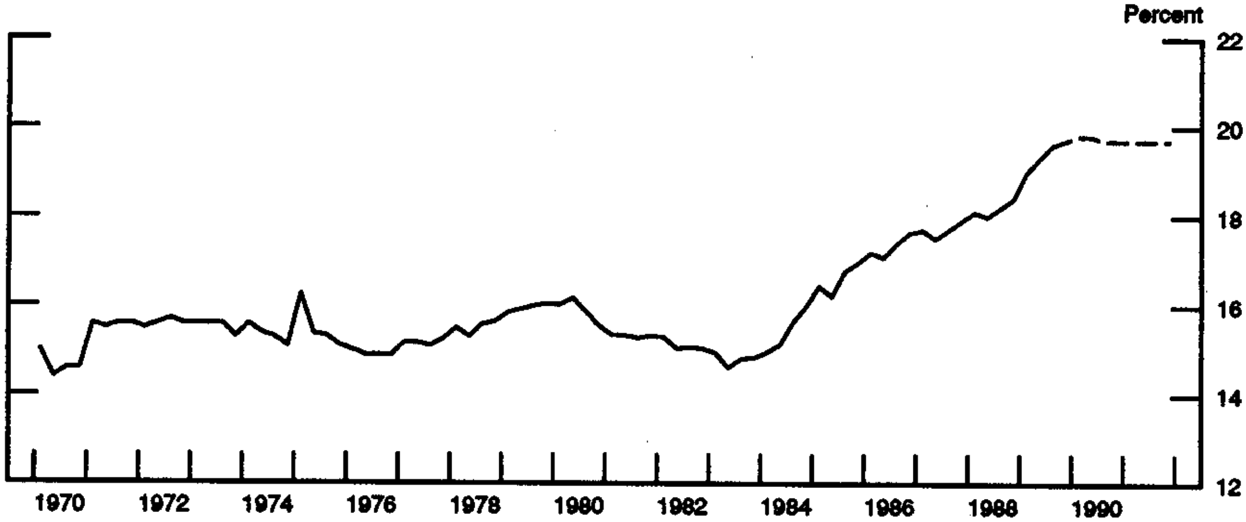
Survey of Terms of Bank Lending

Summary of January 1990 Senior Bank Loan Officer Survey

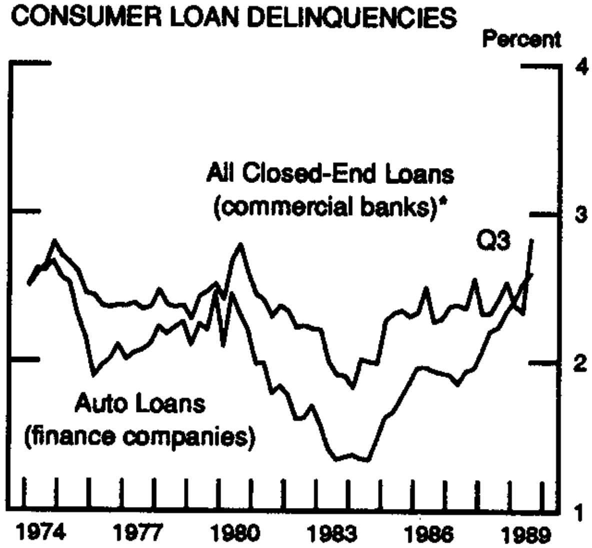
- 72 percent had tightened standards for merger and LBO loans.
- 57 percent had tightened standards for below-investment-grade customers for other than merger and LBO loans.
- 7 percent had tightened standards for investment-grade borrowers for other than merger and LBO loans.
- 81 percent had become less willing to make construction loans.

Chart 13

HOUSEHOLD DEBT SERVICE AS A PERCENT OF DISPOSABLE PERSONAL INCOME

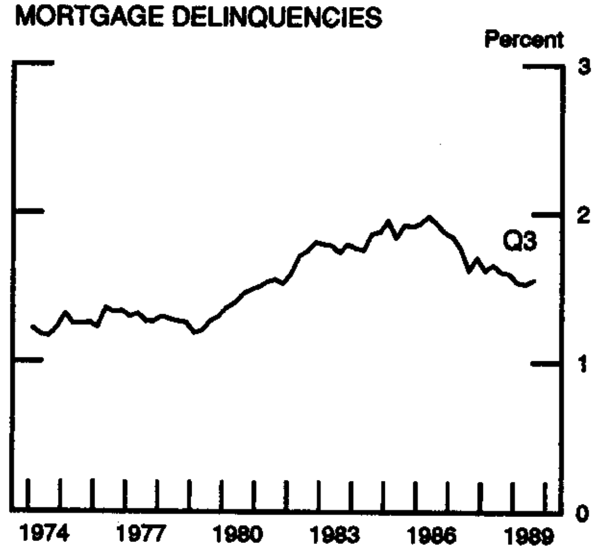


CONSUMER LOAN DELINQUENCIES



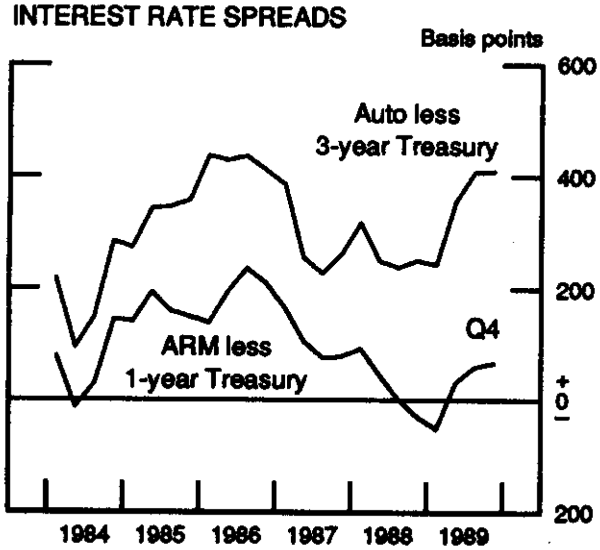
* ABA series, 30 day past due.

MORTGAGE DELINQUENCIES



MBA series, 60 days past due.

INTEREST RATE SPREADS



LOAN TO VALUE RATIOS

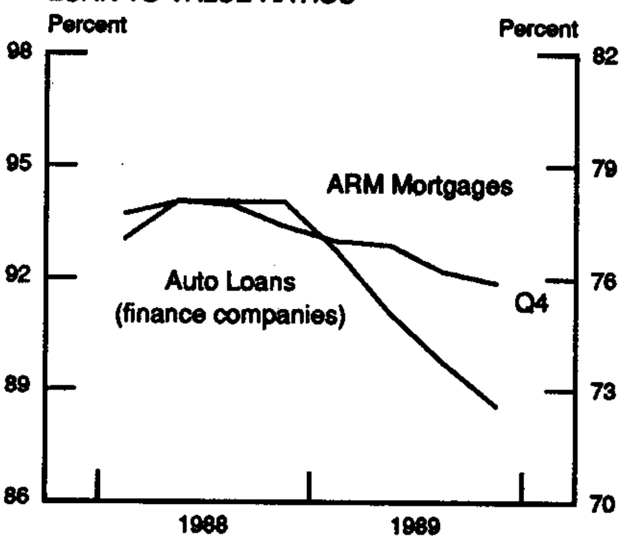
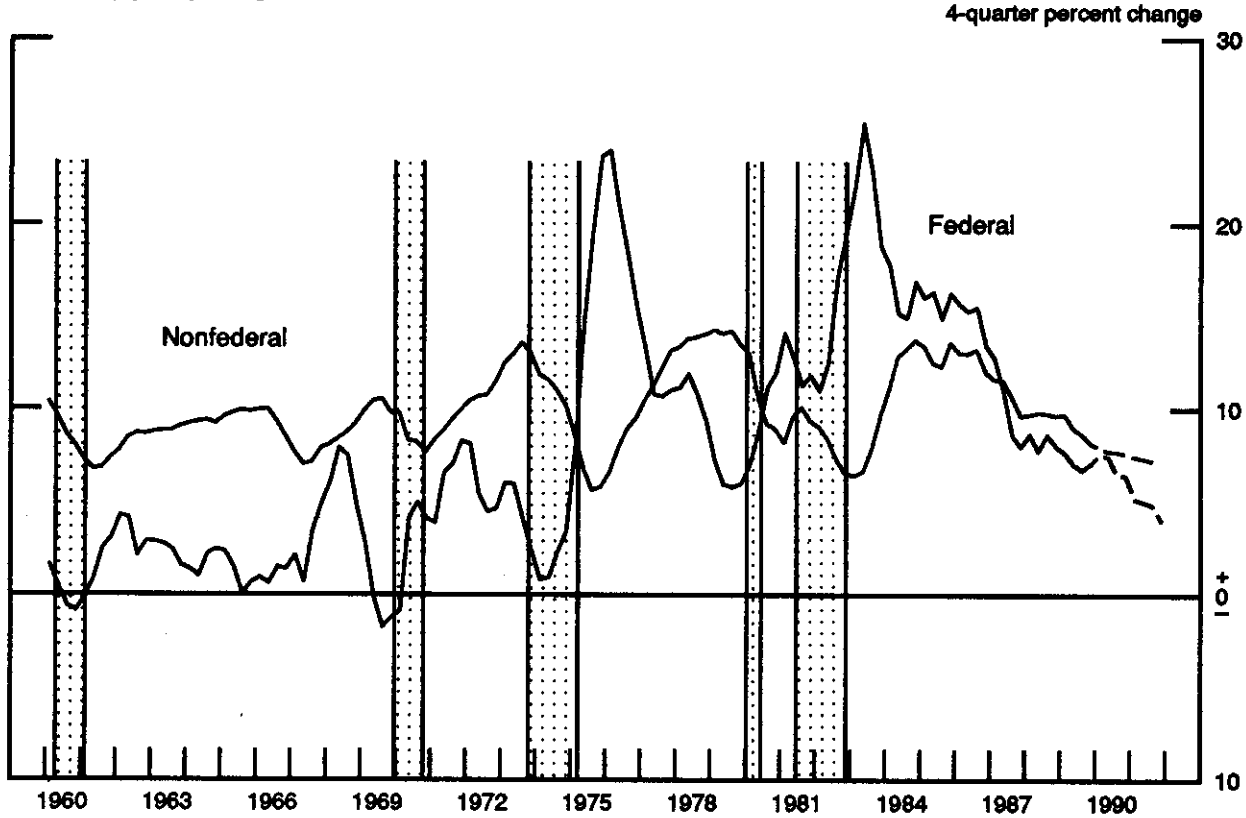


Chart 14

DEBT AGGREGATES



TOTAL DOMESTIC NONFINANCIAL DEBT AND NOMINAL GNP

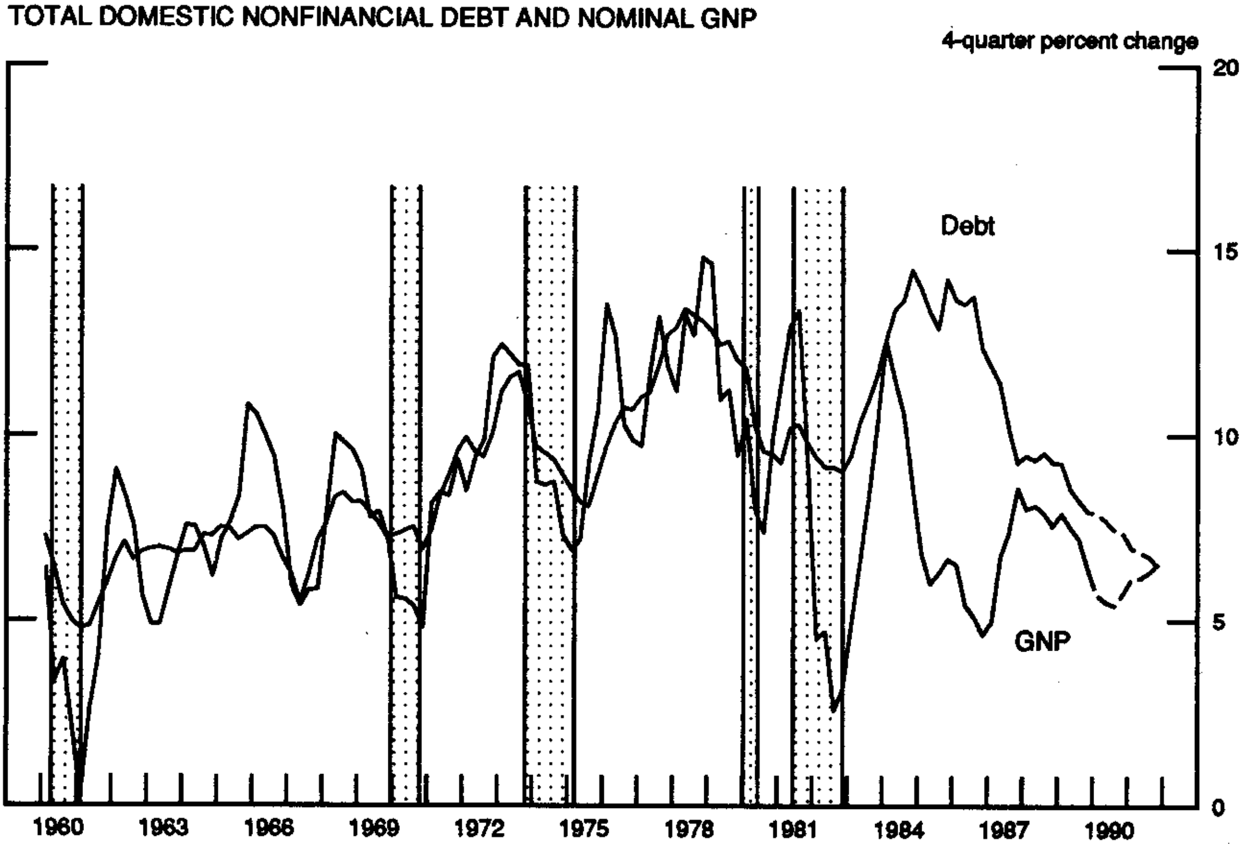
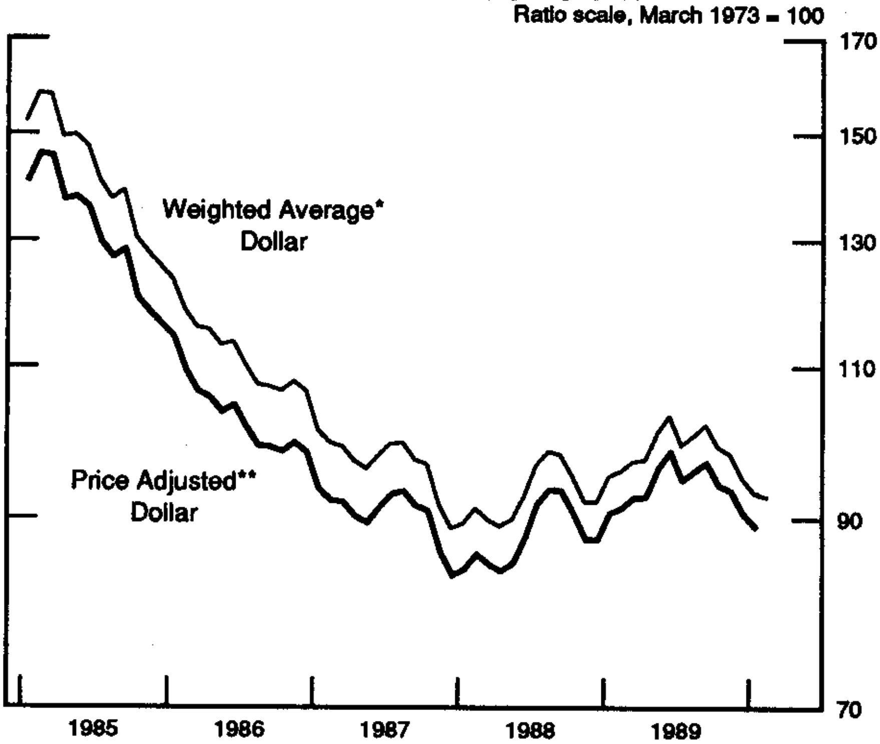


Chart 15

FOREIGN EXCHANGE VALUE OF THE U.S. DOLLAR

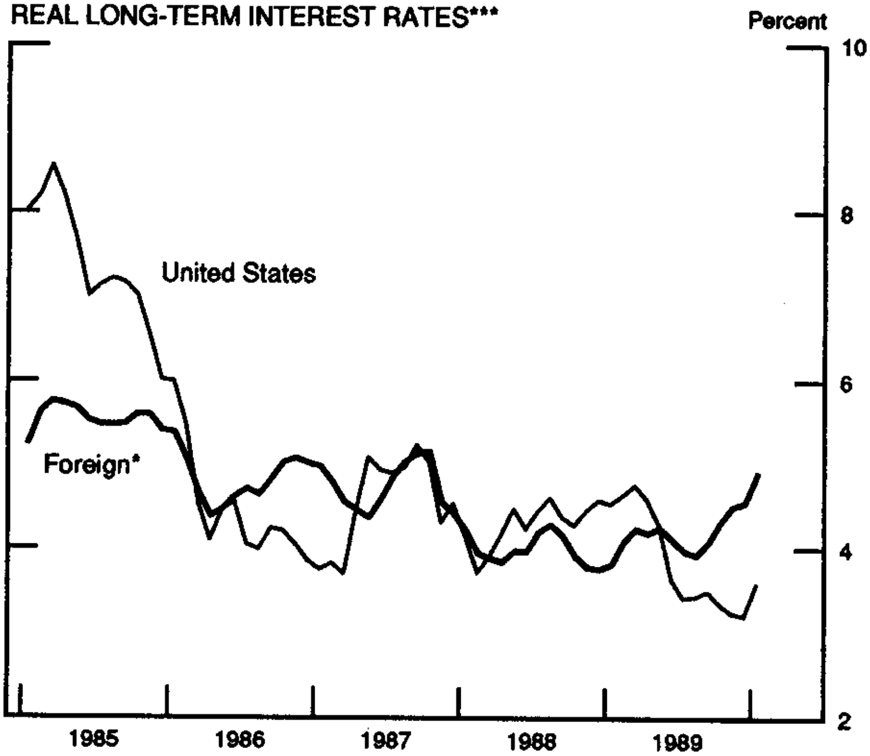


Selected Dollar Exchange Rates

Percent change 6/89 to 2/2/90

Deutschemark	–15
Yen	1
Pound sterling	–8
Canadian dollar	–1
S. Korean won	3
Taiwan dollar	0

REAL LONG-TERM INTEREST RATES***



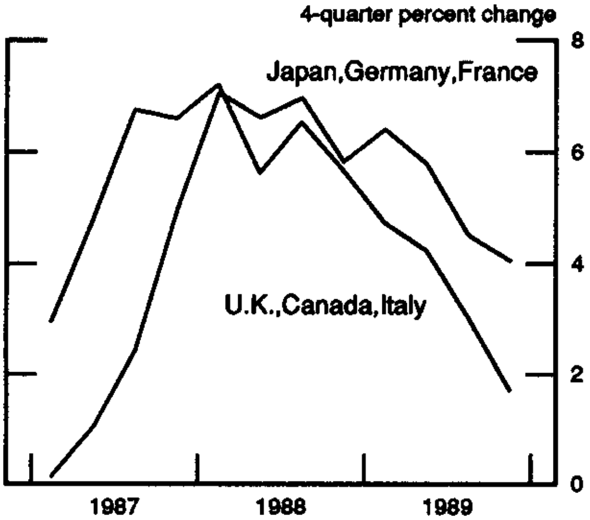
Selected Interest Rates

Percent

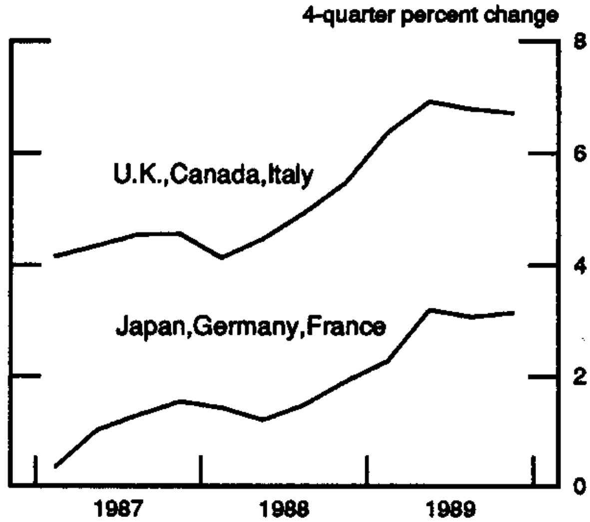
	June 1989	Feb. 2 1990
Three-month		
Germany	6.92	8.05
Japan	5.35	7.06
U.S.	9.20	8.20
Long-term		
Germany	6.92	8.05
Japan	5.08	6.58
U.S.	8.28	8.42

* Weighted average against or of foreign G-10 countries using total 1972-76 average trade.
** Adjusted by relative consumer prices.
*** Multilateral trade-weighted average of long-term government or public authority bond rates adjusted for expected inflation estimated by a 36-month centered moving average of actual inflation (staff forecasts where needed).

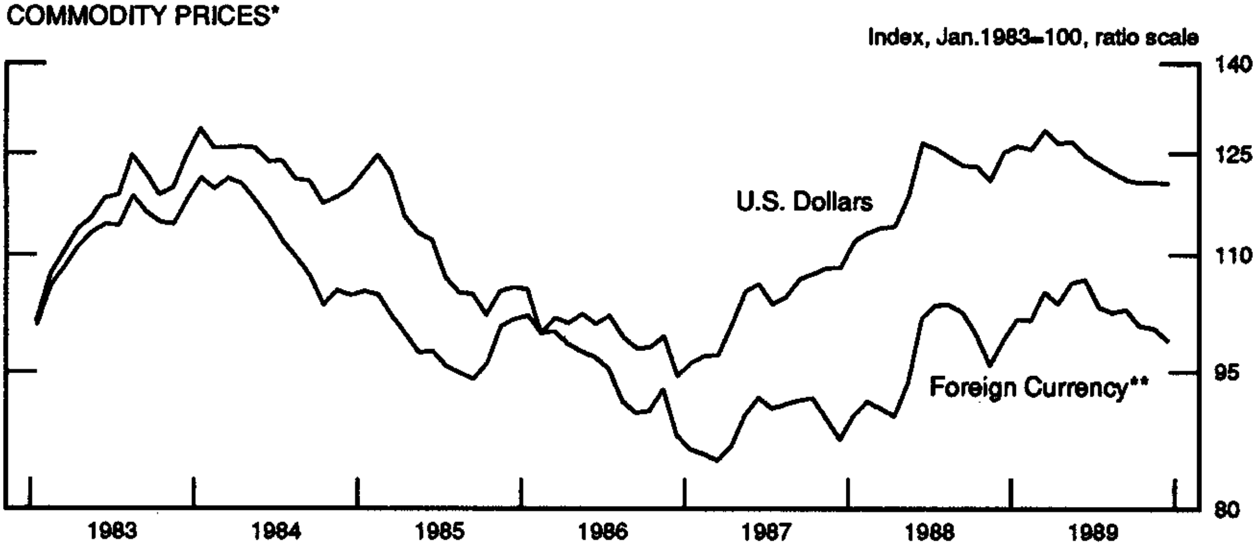
INDUSTRIAL PRODUCTION ABROAD



CONSUMER PRICES ABROAD



COMMODITY PRICES*



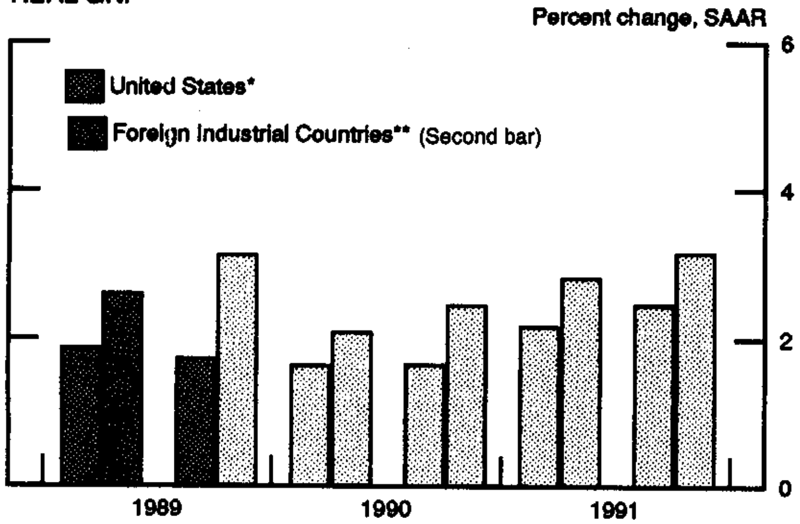
ECONOMIC POLICY ABROAD

- Inflation flat recently; continued concern about capacity pressures and upcoming wage negotiations.
- Tight monetary stance, with gradual decline in interest rates in 1990-H2 and 1991 as growth slows.
- Fiscal policy generally neutral; tax reduction in 1990 and additional spending in Germany related in part to East European immigrants.

* Federal Reserve Board experimental index excluding crude oil.
** Weighted average for the six major foreign industrial countries using 1982 GNP.

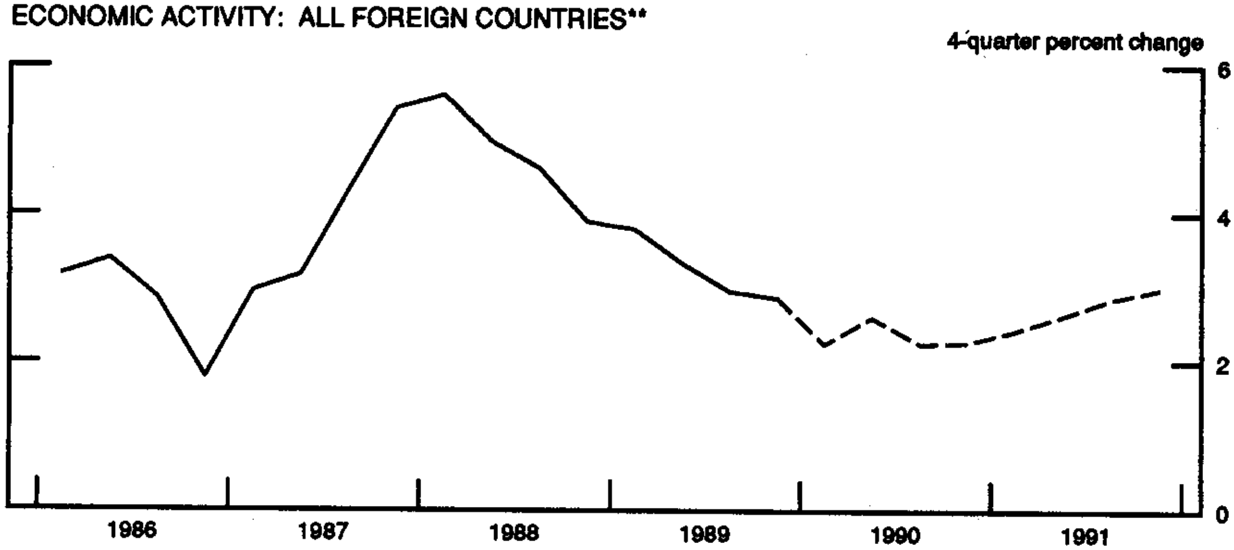
Chart 17

REAL GNP

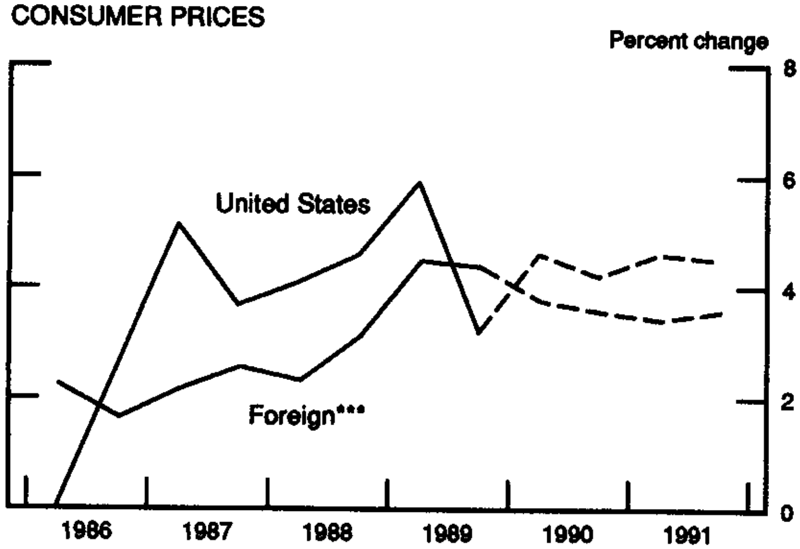


Foreign**		
Percent change, Q4 to Q4		
	GNP	Domestic Spending
1988	3.9	4.0
1989	2.9	3.5
1990	2.3	2.7
1991	3.0	3.1

ECONOMIC ACTIVITY: ALL FOREIGN COUNTRIES**



CONSUMER PRICES



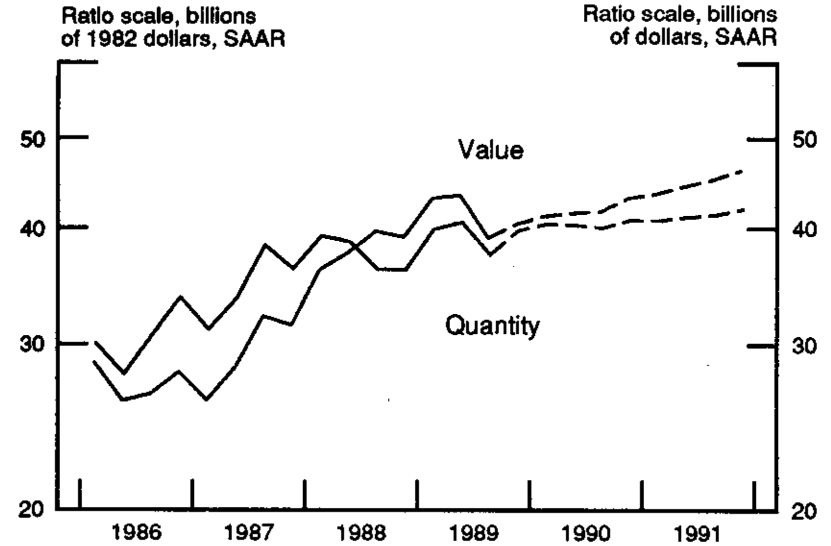
Percent change Q4 to Q4		
	Foreign***	U.S.
1988	3.1	4.3
1989	4.3	4.5
1990	3.5	4.4
1991	3.5	4.5

* Excludes drought effects.
** Weighted average using U.S. non-agricultural exports, 1978-83.
*** Weighted average for the six major foreign industrial countries using 1982 GNP.

Chart 18

Exports

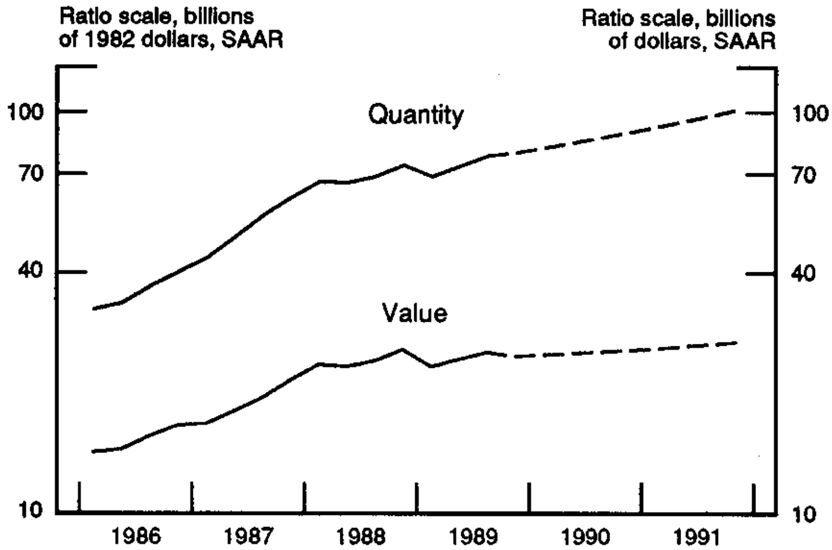
AGRICULTURAL EXPORTS



Percent change Q4 to Q4

	1989	1990	1991
Value	3	7	7
Price	–7	4	4
1982$	10	3	3

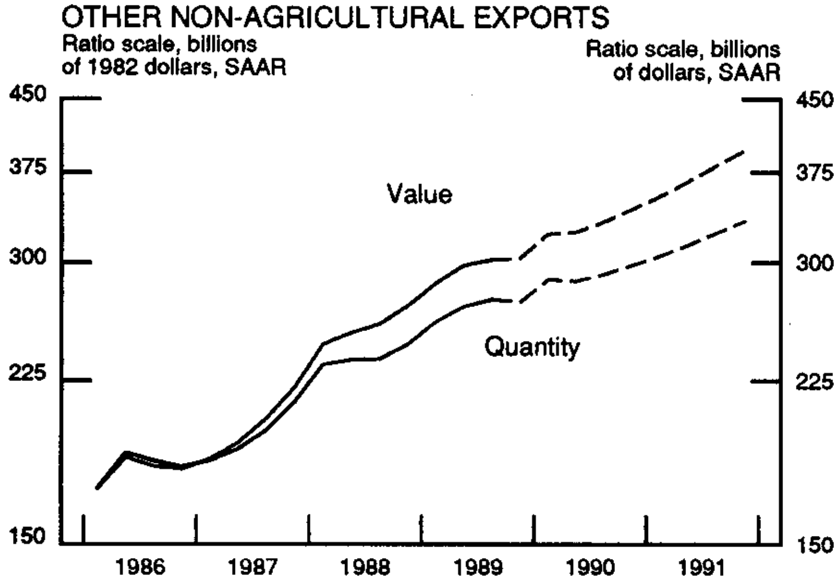
COMPUTERS



Percent change Q4 to Q4

	1989	1990	1991
Value	–4	4	5
Price	–11	–8	–8
1982$	8	13	14

OTHER NON-AGRICULTURAL EXPORTS



Percent change Q4 to Q4

	1989	1990	1991
Value	12	13	16
Price	1	3	4
1982$	11	9	12

Chart 19

Non-oil Imports

PRICES

Percent change, Q4 to Q4

	1988	1989
1. Food	4	–10
2. Industrial Supplies	14	–1
3. Computers	–1	–11
4. Other Capital Goods	6	–1
5. Automotive	6	2
6. Consumer Goods	5	2
7. Other	7	0
8. Total Non–oil	**7**	**0**

NIPA fixed–weight indexes

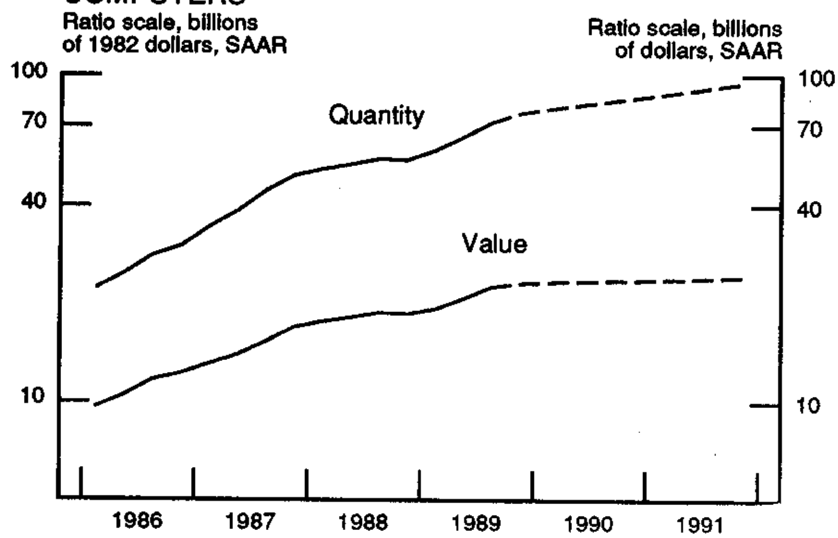
QUANTITIES

Percent change, Q4 to Q4

	1988	1989
1. Food	–5	11
2. Industrial Supplies	–2	–1
3. Computers	11	39
4. Other Capital Goods	9	8
5. Automotive	0	–10
6. Consumer Goods	5	6
7. Other	11	4
8. Total Non–oil	**4**	**7**

NIPA accounts

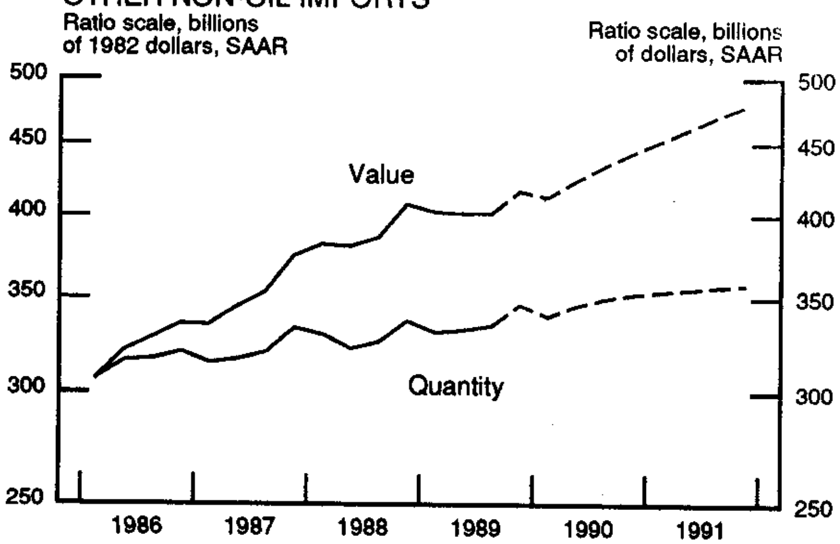
COMPUTERS



Percent change Q4 to Q4

	1989	1990	1991
Value	24	2	3
Price	–11	–8	–8
1982$	39	11	11

OTHER NON-OIL IMPORTS

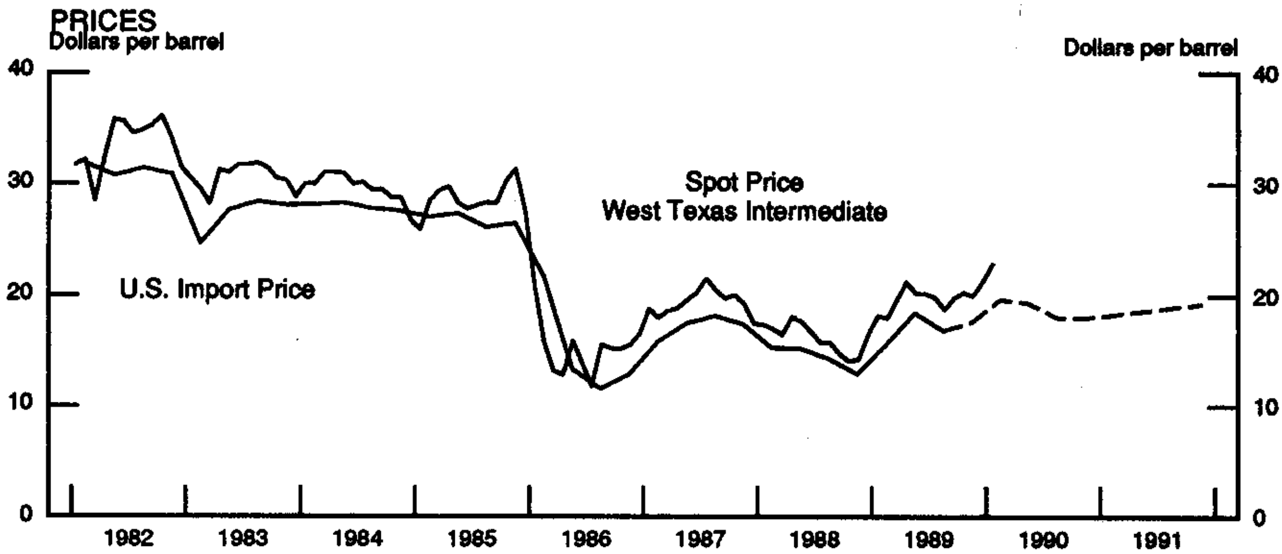


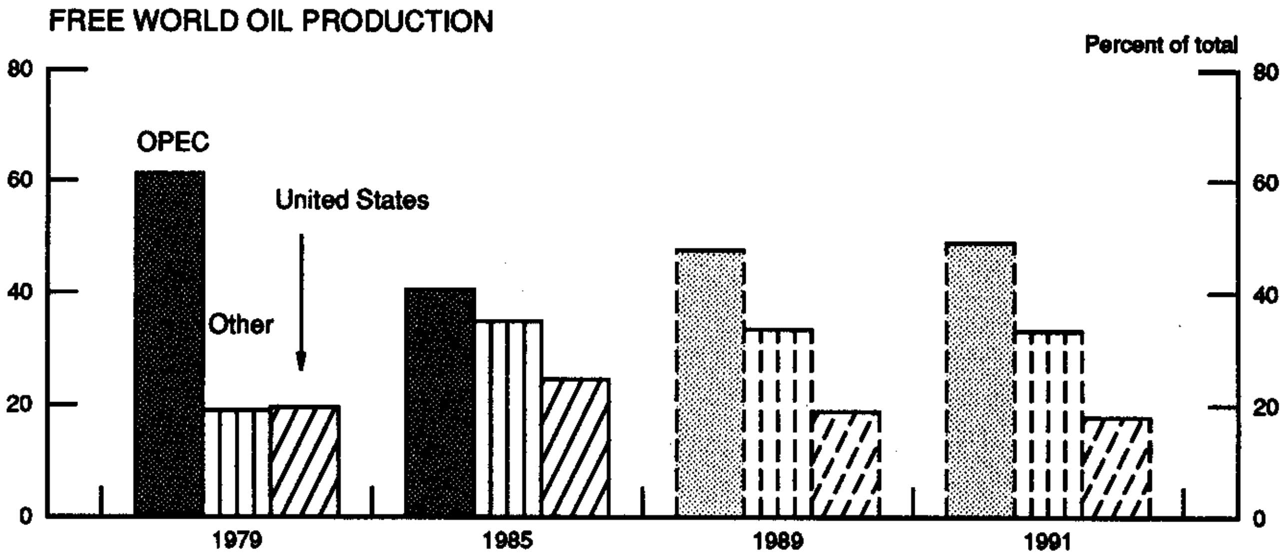
Percent change Q4 to Q4

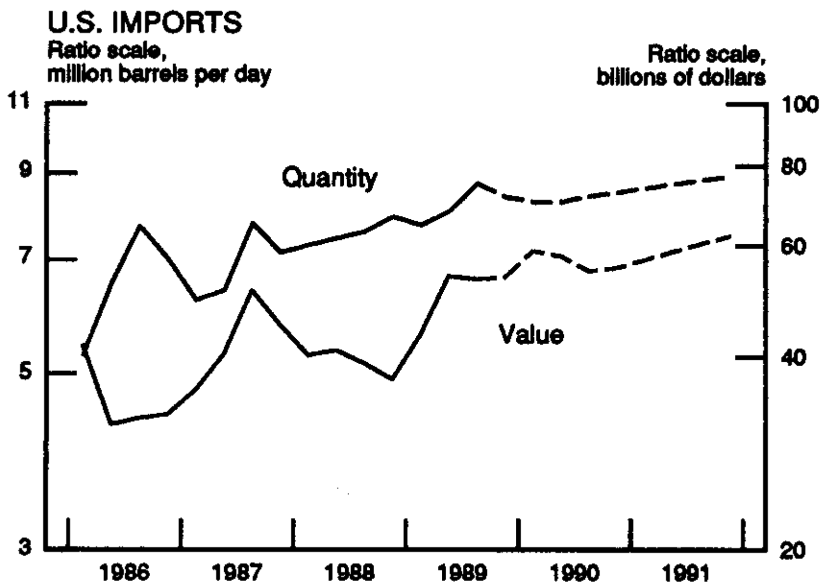
	1989	1990	1991
Value	2	6	8
Price	0	5	6
1982$	3	2	2

Chart 20

Petroleum and Products







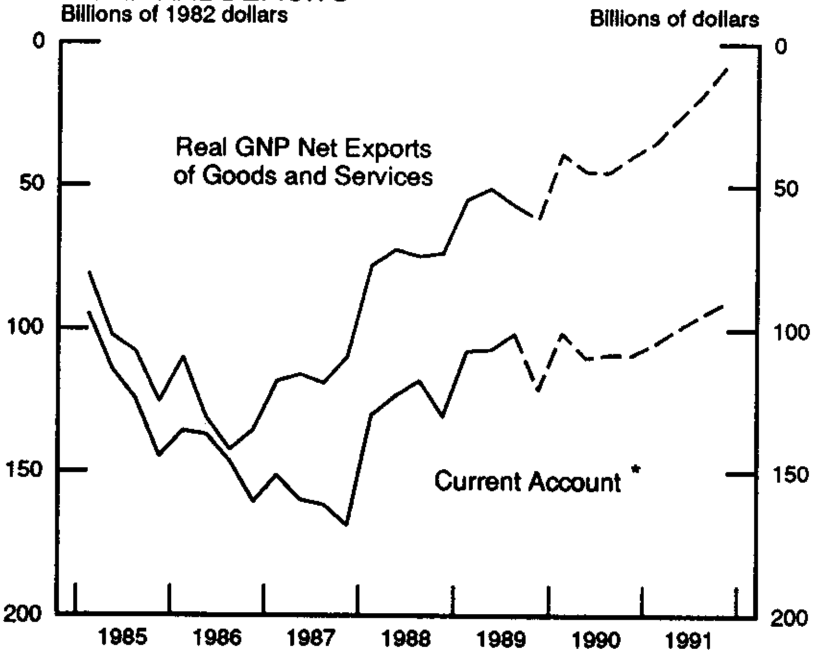
Q4 Level

	Price ($/barrel)	MBD
1988	12.85	7.8
1989	17.60	8.3
1990	18.00	8.4
1991	19.25	8.8

Chart 21

U.S. External Accounts

EXTERNAL DEFICITS



Billions of dollars
Annual rate, Q4

	1989	1990	1991
Merchandise Trade	–125	–111	–96
Current Account *	–121	–109	–90
Real Net Exports	–62	–40	–8

* Excludes capital gains and losses.

U.S. CAPITAL TRANSACTIONS

Billions of Dollars, Net Inflows = +

	1987	1988	1989 e	1990 p
1. **Private Capital, net**	**103**	**105**	**88**	**74**
2. U.S. Banking Offices [1]	47	21	12	15
3. Bonds and Stocks [1 2]	26	36	45	38
4. Direct Investment [2 3]	22	43	26	17
5. Other Flows	8	5	5	4
6. **U.S. and Foreign Official Assets**	**55**	**32**	**–16**	**22**
7. United States [1] (increase = –)	10	–7	–27	1
8. Other G–10 Countries	39	16	–4	16
9. Other Countries	6	23	15	5
10. **Statistical Discrepancy**	**2**	**–11**	**37**	**11**
Memo:				
11. Current Account [3]	–160	–126	–109	–107
12. U.S. and Other G–10 net Purchases of Dollars	97	2	–72	n.a.

1. The refinancing of foreign governments' military sales debt through the sale of securities guaranteed by the U.S. government has been excluded from changes in U.S. government assets, U.S. purchases of foreign securities, and changes in bank custody claims on foreigners.
2. Transactions with finance affiliates in the Netherlands Antilles have been excluded from direct investment and added to foreign purchases of U.S. securities.
3. Excludes capital gains and losses.

e = estimate
p = projection